

Sale of Space for Online Advertisement is Royalty & Taxability of Payments for Google AdWords Programme

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Introduction:

When it is seen from the commercial perspective, the word 'advertisement' plays a vital role in the success of any business or commercial activity. The main objective of any advertisement is to reach out to customer and increase awareness of brand/product/service.

The word 'internet/digital' has changed the lifestyle globally including the way of conducting a business or transaction. Advertisement is not an exception in digital model and in fact online advertisement has created lot of new business opportunities across the globe.

Before understanding income tax implications on digital advertisement, it is required to understand how such digital advertisement would be made.

Under digital/online advertisement, companies provide advertisement space/content to intended advertiser and such space be provided on website/servers owned by such companies. Against the service of providing online space for advertisement, customer who intends to place advertisement pays the fee for such services (ex: Google, Facebook, LinkedIn etc.)

In the above-mentioned transaction, when the payment is being made to foreign companies, especially when the servers are maintained outside India, how to tax such income was a big challenge to tax authorities across the globe.

Online advertisement is one among the transactions which are performed through digital mode. To tackle the issue of taxation of digital economy, OECD¹ has come out with Action Plan 1 of BEPS² project which deal with Tax Challenges Arising from Digitalization. Under the Action Plan 1 of BEPS, OECD has recommended to implement any of the following measures to tackle the issue of taxation of digital economy:

- Introduction of Equalization levy.
- Introduction of SEP³
- WHT⁴ on e-commerce transaction

In this Article, the concept of online advertisement and its taxation under the ITA⁵ has been discussed. To tackle the taxation of online advertisement, Government of India through the Finance Act, 2016 has introduced concept of equalization levy. Besides the equalization levy, section 9(1)(vi) of the ITA deals with the taxation of income by way of royalty. After the introduction of equalization levy, there was a big debate across the industry whether the payment made for online advertisement space is taxable as royalty or equalization levy.

Amount Paid to Advertisement Space – Royalty?:

In the case of Yahoo India (P.) Ltd⁶, assessee has made payment to the Hongkong based company for placing a banner advertisement which is known as web banner. In this case, assessee acquires online/digital space from the Hongkong based company to place the advertisement of a

¹ Organisation for Economic Co-operation and Development

² Base Erosion and Profit Shifting

³ Significant Economic Presence

⁴ Withholding Tax

⁵ Income Tax Act, 1961

⁶ [2011] 11 taxmann.com 431 (Mumbai)

third party. Assessee has contended that the payment is in nature of business income and as Hongkong company does not have business connection in India, such payment is not liable to tax in India. However, revenue has contended that the assessee has acquired the advertisement space for a specific period which is in nature of payment made for the use or right to use any industrial, commercial or scientific equipment and hence, payment made to Hongkong Company is taxable in India as royalty.

In this regard, the Mumbai Tribunal has held that uploading and display of the advertisement on its portal is the responsibility of the Hongkong company and assessee is required to provide to banner (content) to Hongkong company. Accordingly, the Tribunal has held that as there is no use/right to use of the said equipment by the assessee, such payment is taxable only as business income and not as royalty. Same view has been followed by Mumbai Tribunal in Pinstorm Technologies (P.) Ltd⁷.

Similarly, when payment is being made to Facebook Ireland Inc for purchase of online advertisement space, relying on the judgement in the case of Yahoo India (P.) Ltd (supra), the Delhi Tribunal in the case of Lenskart Solution (P.) Ltd⁸ has held that those payments are not taxable in India in the absence of permanent establishment.

In case of ESPN Digital Media (India) (P.) Ltd⁹, Indian company has entered into agreement with the UK Company to purchase online advertisement space which was to be sold to advertisers in India. In this regard, the AO¹⁰ has considered that Indian company is making the payment for use of right to use Industrial, commercial or scientific equipment hence, such

payment is taxable. In this regard, the Chennai Tribunal has held that there is no such use or right to use of any industrial, commercial or scientific equipment. Further, Tribunal has held that the legislature's intention to insert equalization levy is to tax payment made for online advertisement. If such payment is taxed royalty, it may vitiate the intention behind the insertion of equalization levy. Hence, the tribunal concluded that the payment made by the Indian company for purchase of online advertisement is not taxable as royalty.

Google AdWords Programme:

The issue has come up for a discussion in the context of Google AdWords Programme. Google has implemented different approach while providing the online advertisement program. In this case, Google India Limited ('Google India') has entered into agreement with Google Ireland Limited ('Google Ireland') to provide IT and ITeS service. In addition to the provision of above service, Google India has entered into distribution agreement with the Google Ireland in respect of Adwords Programs. Unlike to the facts of the Yahoo India (P.) Ltd (supra), Google India acted as distributor of AdWords Program.

Considering the above facts, Bangalore Tribunal in the case of Google India (P.) Ltd¹¹ has found that, based on the access to personal information, IP address, history of user and contents of more than 2 million websites, assessee [Google India] was in a position to provide effective campaign to the advertiser. Tribunal has further found that assessee [Google India] has not just provided distribution services but also provided various services termed as ITeS services to enable the

⁷ [2012] 24 taxmann.com 345 (Mumbai)

⁸ [2022] 140 taxmann.com 242 (Delhi - Trib.)

⁹ [2022] 140 taxmann.com 442 (Chennai - Trib.)

¹⁰ Assessing Officer

¹¹ [2022] 143 taxmann.com 302 (Bangalore - Trib.)

Google Ireland to provide more effective and focused advertisement services.

Further, Tribunal has found that in the case of Yahoo India (P.) Ltd (supra), assessee is either an advertiser or acts on behalf of some other advertiser and has purchased space from the owner of search engine to display its advertisement. Hence, in those cases it was held that payment made to foreign entities are taxable only under business head.

However, in the present case, Google India has not merely purchased the advertisement space but provided distribution services for AdWords program. Under such distribution agreement, assessee must provide pre-sale and after sale services with the help of ITeS division. Further, Bangalore Tribunal has held that equalization levy is applicable only on services but not for use of IPR, copy right or intangibles. Accordingly, Bangalore Tribunal has held that payment made by the Google India to Google Ireland is liable to tax in India as royalty.

Aggrieved by the above judgement, Google India has approached the High Court of Karnataka. Considering the appeal filed by Google India, the Karnataka High Court has held that some material gathered behind back of the assessee has been used by the Tribunal and those material neither supplied to the assessee nor found place in the Tribunal's order. Accordingly, the Karnataka High Court has remanded the matter to the Tribunal to decide the appeal fresh.

Meanwhile, the long-litigated matter in respect of payment made towards usage of a copyrighted article as royalty has been completed at apex court level. The Hon'ble Supreme Court (SC) in the case of Engineering Analysis Centre of Excellence

(P.) Ltd¹² has held that payment made by the end users or distributors to non-residents for under distribution agreement in respect of resale of computer software program is not a payment for royalty.

In Remand Proceedings:

In the second round of proceedings, the Tribunal has made the following observations:

- In respect of invoking provision of section 9(1)(vi), Tribunal has relied upon the SC judgment in case of Engineering Analysis Centre of Excellence (P.) Ltd (supra) and held that as the provisions are treaty are more beneficial to the assessee, definition under Article 12(3) of India – Ireland treaty must be considered in determining whether such payment is royalty or not.
- Provision of ITeS by Google India are not interlinked with distribution agreement for AdWords program. Even otherwise, those tools, intangibles or software of Google Ireland has not been transferred to Google India.
- Royalty under Article 12(3) of India – Ireland DTAA is defined to mean payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph film or films or tapes for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process or for the use of or the right to use industrial, commercial or scientific equipment, other than an aircraft or for information concerning industrial, commercial or scientific experience.

¹² [2021] 125 taxmann.com 42 (SC)

- In order to treat the payment made by the Google India as royalty, there has to be a use or right to use of any copy right. As far as AdWords program is concerned, it is essential a computer software and issue relating to the computer software has been resolved by the SC in the case of Engineering Analysis Centre of Excellence (P.) Ltd (supra).
- Considering the various facts of the case, Tribunal has held that none of the rights in copy rights have been transferred by the Google Ireland to Google India.
- With regard, applicability of use of or right to use trademarks, other brand features and the process owned by Google Ireland for the purpose of distribution of AdWords program, Tribunal has held that Google Ireland grants non-exclusive and non-sublicensable license during the term to display Google brand features solely for the purpose of distributor's marketing and distribution of AdWords program under the terms and subject to the conditions. Hence, such payment cannot be considered as royalty.
- Further, with regard to classifying the payment as consideration for use of or right to use industrial, commercial or scientific equipment, Tribunal has upheld the findings of the CIT(A) who held that Google Ireland has not parted with the copyright it holds in the AdWords program and hence it cannot be said that any kind of technical knowhow has been transferred to Google India.

- Further, the Tribunal has opined that while interpreting the definition of royalty under Article 12(3) of India-Ireland treaty, it is relevant to take note of international jurisprudence. In this regard, the Tribunal has relied upon report of the TAG¹³ of OECD where in the TAG has recommended that payment made for online advertisement shall be taxable as business income under Article 7 of the treaty.
- Further, the High-Powered Committee on electronic commerce and taxation which has been setup by the CBDT, has accepted the recommendations of the TAG and recommended to tax such payment as business income under Article 7 of the treaty.
- Further, Tribunal has also referred to the introduction of the equalization levy by the Finance Act, 2016 to tax the payment made for online advertisement.
- Finally, considering the jurisprudence by various Tribunals and Courts, the Bangalore Tribunal has held that payment made by the Google India to Google Ireland for Adwords Program is not taxable as royalty.

Author's Comments:

While determining the taxability of payment made by the Indian company, Tribunal has analysed various categories of payments under Article 12(3) which may be beneficial other matters as well.

Once again Tribunal has reiterated that definition of 'royalty' under Article 12(3) has to be considered if such definition is more beneficial to

¹³ Technical Advisory Group

the assessee. This view has also been upheld by the Chennai Tribunal in the case of ESPN Digital Media (India) (P.) Ltd. (supra) wherein the Tribunal has held that unilateral retrospective amendments made to section 9(1)(vi) cannot override the more beneficial definition of royalty under Article 12/Article 13.

Though, the payment under AdWords program by Google India is different from payment made by the other advertisers viz. payment made to Yahoo, Google Ireland etc. by other Indian entities, Tribunal has held that payment made by the Google India to Google Ireland is also not taxable. Further, Tribunal has held that these payments are taxable under equalization levy which may be considered as more clarification from the judicial fora.